April 5, 2009

RE: Advance Notice of Proposed Rulemaking to 12 CFR Part 704

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Dear Ms. Rupp,

This letter is Insight Financial Credit Union's (Insight) response to the National Credit Union Administration (NCUA) Advance Notice of Proposed Rulemaking (ANPR) to 12 CFR Part 704 and request for comment concerning the role of corporate credit unions in the credit union system. We thank you for the opportunity to provide our comments and contribute to the process of restructuring the corporate credit union network, the outcome of which will have broad impact on the entire industry.

Background

In the past year or two, the corporate credit union network has been affected by the dramatic reduction in the value of houses across the United States. This reduction in home value has resulted in mortgage backed securities (MBS) and other collateralized debt obligations (CDO) held in corporate investment portfolios becoming difficult to value due to lack of market transactions by willing buyers. It should be noted that at the time of purchase this investment had the highest investment grade ratings of the nationally recognized statistical rating organizations (NRSRO). Since providing liquidity for the Natural Person Credit Union (NPCU) system is one of the principal purposes of the corporate credit union network, having non-liquid investment quickly became problematic for several large corporate credit unions. Because of this, in January 2009, the NCUA Board provided a capital infusion of $1 billion into the U.S. Central Federal Credit Union, the wholesale credit union to the corporate system, from the National Credit Union Share Insurance Fund (NCUSIF). The NCUSIF has also guaranteed all member shares and deposits for any corporate credit union that participates in a voluntary program offered by NCUA through the year 2010.

Additionally, in March 2009, the NCUA Board placed into conservatorship two corporate credit unions, U.S. Central Federal Credit Union and Western Corporate Federal Credit Union. This action was a direct result of the reduction in the aggregate value of their MBS and CDO investment portfolios.

The NCUA Board issued an ANPR to help identify issues with the corporate network that may have contributed to their current investment and capital problems, and to solicit comments on how the corporate network may be improved for the future needs of the credit union network.
The NCUA stated its goal for this ANPR to be:

"The Board believes that identifying and addressing the issues discussed in this ANPR will help continue to assure stability and confidence in the corporate credit union system in the future."

These are the issues that Insight Financial Credit Union will address

Insight will address each of the following issues separately:

- *Payment Systems*
- *Liquidity*

- *Structure/Field of Membership*
- *Investment Authorities & Risk*
- *Corporate Capital*
- *Corporate Governance*

Payment Systems

Should payment system services be isolated from other corporate services to separate the risks?

Insight's opinion is that it is not necessary to isolate payment services from other service activities in order to separate the risks. We believe the NCUA is concerned about the risk associated with inadequate dollars for fund settlements. Payments consist of two primary functions: those being the processing of the transaction and the settlement of funds. Payment systems always require that sufficient funding is available. Settlement funds must be maintained in a liquid form. Payments are highly scalable and benefit from consolidations that result in lower costs. The corporate system has been able to perform the payment functions very well and NCUA has confirmed this fact through their examination process. We believe that NCUA is concerned with settlement funds not the processing function. Separating the payment services from other corporate services will likely add additional cost and inefficiencies to a corporate and its member credit union without a corresponding reduction in risk. Insight believes that a review of the payment services should be made with the focus on generating efficiencies through consolidations within the corporate credit union system.

Liquidity

Liquidity being a core corporate service, what steps should be taken to preserve and strengthen it?

Insight believes that liquidity is a core corporate service and that additional steps can be taken to preserve and strengthen that service using the following tools and conditions:

- Access to the CLF would help in periods of unusually constrained liquidity
- Limit the ability for a corporate to borrow for investment purposes
- Impose minimum liquidity requirements
- Require additional interest rate sensitivity testing
- *Allow Settlement Loans*
- *Permit Demand Loans*
- *Permit Term Loans*
- *Allow Collateralized Loans*
- *Allow Reverse Repurchase Loans*

Historically, corporates have effectively managed investments and ensured that funds were available to meet member credit union short-term liquidity needs. However, recent events underscore the need for corporates to reevaluate their investment positions relative to their cash flow needs. Insight believes that if a spread duration requirement was added to the ALM process, along with the use of effective duration measures, the result would provide a more accurate tool for the measurement of risk.

In addition, there should be some measure of a spread duration requirement added to the ALM procedure. This concept would show the effect of the spread widening on NEV and the entire balance sheet when shocked. This measure may provide a better view of the effect of spread widening on the whole entity rather than just on individual securities. The extent of a corporate's spread risk tolerance should consider the liability portion of a balance sheet as well as the amount of risk that is being offset by the corporate's liabilities.

Corporates should not engage in activities that may harm their ability to act as an effective liquidity provider. Therefore, the use of excessive leverage in order to arbitrage should be restricted, but not completely eliminated.

A key shortcoming in the corporates' role as a liquidity provider to NPCU's in the present economic crisis has been the lack of access to liquidity during periods of unusual market constraints. Because of this, Insight recommends that corporate be provided with direct access to the CLF, so that they may effectively engage in their function as a liquidity provider to NPCU's.
Insight is using each of these services with our corporate credit union, Southeast.

- *Automated Settlement*
- *Check/Image Processing*
- *Remote Deposit Capture*
- *Automated Clearing House (ACH) Processing*
- *Cash Services*
- *Wire Transfers*
- *Cash Management*

If Southeast Corporate was not able to offer these services, or did not exist, then Insight would have had to find another source for these services within the financial industry which most likely would have resulted in a much higher cost to our credit union.

Structure/Field of Membership

Does the current two-tier structure meet credit union needs?

We believe that the credit union network current structure meets most credit union needs, but it is inefficient and concentrates risk. The current two-tiered system poses systemic risk. The conservatorship of U.S. Central resulting in the write-off of their U.S. Central capital by the corporates, which in turn resulted in the write-off of corporate capital by many NPCU's, is evidence of this risk. One of the issues that we must address with the current system is that the layer of a "wholesale" corporate masks the complexity of the investing it is engaging in. Mortgage Backed Derivatives are very complex and some corporates made investments in these derivative products without fully understanding their risks.

Insight recommends that the NCUA design a new structure consisting of five to eight regional corporate credit unions. This structure would be more efficient than the current configuration of twenty six corporates. A regional structure would better spread the risk presently concentrated in one credit union, U.S. Central. Also, the system would be large enough to be efficient and diverse enough to mitigate risks.

Competition should come from outside the network and would provide sufficient force to drive competitive market rates and products and services. A move back to a small number of regional corporates with narrowly-defined fields of membership is needed for a return to the cooperative relationship the network enjoyed in the past. That relationship proved to be very beneficial to the individual corporates and their NPCU members.

Should the network return to restricted fields of membership?

A network of corporate credit unions with defined fields of membership would still allow for the sharing of best practices without the associated pressures to assume needless risks or unprofitable pricing of products and services. Granting corporates national FOM's fostered competition among the corporates but resulted in increased risk taking, insufficient capital building, inappropriate pricing and margin compression. Restricting fields of membership to within a regional structure would reduce pressures on the corporate network to gain advantages over and to out perform each other. Competition would then be replaced with the sharing of best practices and the free market place would ensure that competitive products are offered to member credit unions.

Investment Authorities & Risk

Should corporates continue to be granted expanded investment authorities?

The corporate system should be focused on supporting the investment and borrowing needs of its NPCU members in any economic environment, therefore, as aggregators corporates will need expanded authorities. Investment authority should be standard across the corporate credit union network, and regular validation of each corporate's risk management and investment expertise should be performed. The use of NRSRO rating services in credit valuation of investments will have significantly less value in the future as these rating services have failed the entire financial industry due to their inability to fairly identify the risk associated with MBS's and CDO's. Therefore, corporate management must identify and obtain the necessary tools and resources required to analyze the potential and existing credit risk inherent in their individual investment portfolios.

Insight believes that corporates should be granted expanded investment authorities in order to better serve their members. If the services that our corporate, Southeast, provides, were no longer available to us we would have to seek higher cost services from the financial service industry. A few of these are listed below:

- Transaction/Settlement Accounts
- Overnight Accounts – provide higher returns than fed funds
- Term Certificates – highly competitive yields
- Structured Products
- Securities Safekeeping
- Investment Advisory Service

Corporate Capital

Should new capital requirements be addressed as part of a restructuring of the corporate network?

- Capital requirements should be risk-based, comparable to other depository institutions

Insight believes that corporate capital should be based on risk-weighted measures similar to those that have been established by the Federal Banking Regulators under the Basel accords. This system uses two capital measures: Tier 1 (core capital) and Tier 2 (secondary capital) which are measured as a percent of risk-weighted assets. This methodology should take into account the unique purpose and structure of the corporate network and establish a minimum core ratio requirement which should be based on what we have learn from the current economic crisis. It is important that whatever capital methodology is adopted be applied uniformly across the corporate network.

Member (Core) Capital

Corporates should limit services to only those who maintain capital (ownership) at the corporate.

Corporate credit unions are owned by the member credit unions they serve and exist solely for the benefit of those members. Insight believes that member credit unions must take an active roll in the capitalization of their corporate and that each corporate should be limited to servicing only those credit unions that have contributed to the core capital of a corporate.

Member Capital

Member capital share requirements should be based on the member balance sheet using factors such as total shares, total investments or total assets. Withdrawal of member capital shares should be permitted with prior notice and only if the corporate's minimum capital requirements have been met.

Corporate Governance

What changes should be made to Corporate Governance?

- A significant overhaul of corporate governance is unnecessary;
- Poor corporate governance did not contribute to the current crisis;
- Qualifications and term limits should be determined by member owner credit unions not by the regulators;
- Modest compensation of directors should be considered as a means of attracting the brightest and best;
- Disclosure of executive compensation should be at the discretion of the board of directors and not dictated by regulation; and
- The present financial crisis is a global financial crisis, not unique to the U.S. and it is not based on corporate governance issues.

In soliciting ANPR comments NCUA stated:

"As with all credit unions, corporate credit unions are organized as cooperatives, owned by their members and responsive to their needs, enabling members to receive access to necessary products & services at affordable rates."

The current credit union system structure is such that in a natural person credit union (NPCU) individual members cooperatively own and govern their particular credit union. In turn, NPCU's cooperatively own and govern corporate credit unions, and corporate credit unions cooperatively own and govern the U.S. Central Federal Credit Union.

It is appropriate that the Board of Directors of the corporate credit unions be managed by representatives from NPCU's. Insight supports the current make-up of directors with direct ties to the credit union movement for who is better qualified to determine the types of services and products that the corporate should offer to NPCU's. We do not believe that the root of the problems caused by a select group of corporate credit unions was a result of the board of directors' expertise. A corporate board is comprised of CEO's and other officials of NPCU's fully experienced in the things affecting financial institutions and markets. We can just look to the boards and managers of AIG, Bear Stearns, WAMU, the Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation and see that even the most knowledgeable and "professional" boards were not prepared for the events of the past few years which lead up to and contributed to the crisis we are now experiencing with the financial markets.

Thank you for the opportunity to comment on this important Advance Notice of Proposed Rulemaking.

Sincerely,

Richard H. Simonton, Sr.
President/Chief Executive Officer
Insight Financial Credit Union